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**BEFORE THE  
UNITED STATES HOUSE  
COMMITTEE ON FINANCIAL SERVICES**

**OCTOBER 3, 2002**

Chairman Oxley, Ranking Member LaFalce, Distinguished Members of the Committee:

Thank you for the opportunity to join you this morning to discuss a major initiative of the Bush Administration: our unprecedented effort to increase homeownership by making the home financing process more transparent, simpler, and less costly.

We are committed to eliminating the homeownership gap that exists today between the minority population and the rest of the country. The President has set a national goal of creating 5.5 million new minority homeowners by the end of this decade. Our comprehensive plan for achieving this combines new initiatives and expanded programs with public/private partnerships focused on making affordable homeownership an option for more families.

The mortgage finance process and the costs of closing are major impediments to homeownership. Every day, Americans enter into mortgage loans – the largest financial obligation most families will undertake – without the clear and useful information they receive with most any other major purchase.

After agreeing to the price of a house, too many families sit down at the settlement table and discover unexpected fees that can add hundreds, if not thousands, of dollars to the cost of their loan. And at that point, they have no viable options. On the spot, the borrower is forced to make an impossible choice: either hand over the extra cash and sign, or lose the house.

Americans spend approximately \$50 billion each year on settlement costs. I would guess that most of them do not know precisely how much their mortgage loan will cost them until the eleventh hour, and have little or no opportunity to shop for settlement services. As a result, many homebuyers find the settlement process to be filled with mystery and frustration.

It is time to take the uncertainty out of mortgage financing. This Administration is committed to streamlining the process, so consumers can shop for mortgages and better understand what will happen at the closing table. It is for these reasons that HUD has proposed a major overhaul of the regulations governing the Real Estate Settlement Procedures Act (RESPA).

### **RESPA REFORM**

RESPA has been a priority of mine since I came to HUD. Shortly after taking office, I was faced with a major RESPA issue: the legality of yield spread premiums, the rate-based lender payments to mortgage brokers. This issue came to a head following an Eleventh Circuit U.S. Court of Appeals decision in *Culpepper v. Irwin Mortgage* that called into question the legality of these payments under RESPA.

Because the decision potentially jeopardized the legitimate use of these payments to lower upfront settlement costs, HUD issued a further clarification. What became RESPA Policy Statement 2001-1 reiterated our view that as long as the broker's compensation is for goods, facilities, or services, and the total compensation is reasonable, yield spread premiums to the mortgage broker are legal under RESPA.

At the same time, the Department recognized that there were serious disclosure problems involving yield spread premiums. We noted that less-scrupulous brokers often used yield spread premiums to generate additional profits, placing unsuspecting borrowers in higher-rate loans without their knowledge.

In the process of issuing the policy statement, I committed HUD to establishing clearer disclosure rules for mortgage broker fees, and to simplifying and improving the mortgage origination process for everyone involved.

## **BASIS OF THE REFORM EFFORT**

While RESPA, as adopted in 1974, was appropriate for the time, it has not sufficiently evolved and accounted for the many dramatic changes in the lending and housing industries in the past 28 years. The disclosure requirements under RESPA have not been substantially revised in a decade.

And RESPA's promise of reduced settlement costs has yet to be fulfilled.

Reforming RESPA now is the right thing to do. Too many Americans seeking to buy or refinance a home are not as well informed as they need to be. The mortgage origination process is too complicated, too costly, and too much of a mystery for many borrowers. The experts told me that fixing this would be too difficult and too controversial, and our efforts would probably not succeed. But this problem is too important to ignore.

In June, the Administration unveiled a set of principles called the Homebuyer Bill of Rights that will from now on guide the home settlement process. These principles are consumer driven and rooted in the homebuyer's right to know. They stand as the centerpiece of our efforts to empower would-be homeowners – and existing homeowners looking to refinance – through access to mortgage finance information.

The Homebuyer Bill of Rights specifies that:

- Homebuyers have the right to receive settlement cost information early in the process, allowing them to shop for the mortgage product and settlement services that best meet their needs;
- Homebuyers have the right to have the disclosed costs be as firm as possible, to avoid surprises at settlement;
- Homebuyers have the right to benefit from new products, competition, and technological innovations that could lower settlement costs;
- Homebuyers have the right to simplified disclosure and access to better borrower education;
- Homebuyers have the right to know they are protected through vigorous RESPA enforcement and a level playing field for all industry providers.

With these principles to guide us, we undertook a major reform of the regulatory requirements under RESPA.

After months of consultations with industry groups, consumer advocates, and federal agencies, including an initial review by the Office of Management and Budget (OMB), HUD published its reform proposal for public comment on July 29. The comment period is open until October 28, 2002.

We believe that this proposal can reduce closing costs by an average of \$700 per closing. That kind of savings will allow many more Americans currently priced out of the homebuying market to buy a home. The aggregate could result in a savings to consumers of as much as \$8 billion. We also expect our proposal to promote innovation in the marketplace and inspire greater public confidence in the mortgage lending industry.

### **ELEMENTS OF THE PROPOSED RULE**

The Proposed Rule addresses the inadequacies of the existing regulatory scheme by:

- Fundamentally changing the way in which compensation to mortgage brokers is disclosed to borrowers;
- Significantly improving HUD's Good Faith Estimate (GFE) settlement cost disclosure; and
- Removing regulatory barriers to allow the industry the option of offering guaranteed packages of settlement services and mortgage loans to borrowers.

### ***Broker Fees***

Specifically, the Proposed Rule significantly improves the disclosure of payments to mortgage brokers, commonly known as yield spread premiums.

Under current rules, such a payment is frequently reported on the GFE – and later at closing on the HUD-1 – with abbreviations that most consumers are not well informed enough to understand. In addition, the payment is not included in the calculation of broker compensation, nor is it listed as an expense to the borrower. As a result, many borrowers have no idea that they are paying for the yield spread premium in the form of a higher interest rate.

The Proposed Rule would require that all such payments be reported on both the GFE and the HUD-1 as a credit to the borrower toward his or her closing costs.

This means that, when a broker intends to receive any compensation from a lender payment based on the borrower's interest rate, the broker must report it as part of the total origination charge. This preserves the use of rate-based lender payments as a means of paying closing costs while lessening the chance that brokers will use these payments to increase their income without the borrower's knowledge.

### ***The Good Faith Estimate***

The Proposed Rule would further revise the GFE to better achieve the law's basic purposes. Current GFE requirements arguably lessen consumer understanding and increase costs by requiring that every charge, however creative, be itemized on the form.

The new GFE would require that the charges of settlement service providers – the lender, broker, title agent/insurer, and other third parties – be combined and disclosed as a single dollar figure for each major category. The Rule would also establish limits or tolerances to provide clearer standards for good faith estimates of most of these charges. Specifically, the Rule establishes a zero tolerance for the loan origination fee and other services provided or selected by the loan originator, and a 10 percent tolerance for most services provided by third parties. Some costs are not subject to a tolerance – such costs as per diem interest, hazard insurance, and buyer's title insurance, which are outside the control of the loan originator.

These changes to the GFE and the regulatory scheme hold great promise for eliminating duplicative or unnecessary charges, or "junk fees," and will lead to lower settlement costs. We also believe that the new GFE requirements will empower consumers to shop for the best loan to meet their needs; consumers will get the GFE before they have to make a commitment to the lender, giving them time to shop, and the GFE will emphasize the *total* cost of the loan – the bottom line for the consumer.

### ***Packaging***

The Rule permits loan providers to offer guaranteed mortgage packages. This might provide an even better means of encouraging shopping and lowering costs.

Under our packaging proposal, the settlement costs cannot vary from the time the offer is made, and the rate – unless locked by the borrower – can only vary in accordance with an observable index or yardstick. Packages must remain open for 30 days. The fact that these packages will consist of one or two numbers at most will permit true price comparison.

Any entity offering such a package may qualify for a safe harbor from RESPA Section 8 scrutiny if it offers the following – at no charge – to a borrower who submits an application:

- A guaranteed package price for all lender-required settlement services;
- A mortgage loan with an interest rate guarantee; and
- A contract for the transaction in the form of a Guaranteed Mortgage Package Agreement.

The key point with our packaging proposal is that the Rule in no way mandates packaging; it simply makes it available as an option. It is not our

intention to pick winners or losers in the industry but rather to unleash the creativity of the marketplace.

Injecting greater competition into the mortgage lending process and among settlement services is an important reason for reforming RESPA. When consumers are empowered to shop for the best loan to meet their needs, the market will respond to the competition by lowering closing costs. When closing costs are reduced, home loans will become less expensive and more families will become homeowners.

## **RESPONSE TO THE RULE**

Since publication of the Proposed Rule, we have been heartened by the strong support it has received from numerous industry and consumer groups, and governmental agencies. But, some criticisms about the Rule and its possible impacts have been brought to our attention. Some of these criticisms are based on misconceptions that we are attempting to correct. Others are differences that I think can be bridged. In some cases, we may simply have to agree to disagree.

## **RESPA ENFORCEMENT**

Another feature of the Department's reform effort is stepped-up enforcement.

I have committed new resources toward enforcing RESPA – to address current violations and to make certain that the benefits of the proposed reforms are achieved. In conjunction with significantly increasing the level of staff devoted to RESPA enforcement, I have established a new office, along with a new Deputy Assistant Secretary, to bring greater attention and departmental resources to RESPA enforcement.

This summer, the Department announced five major settlement agreements with mortgage lenders and service providers, with payments of nearly \$2.3 million. HUD has budgeted \$1.5 million that is available to investigate RESPA violations. And we are beefing up our investigative staff to further strengthen our RESPA enforcement efforts.

HUD continues to work with other federal and state regulatory agencies, as we did recently with the Federal Trade Commission in the Mercantile Mortgage case, to complement and leverage our enforcement efforts.

You should also know that the Department will continue to defend its position that one settlement service provider's markup of another provider's fee is a RESPA violation. The Department of Justice has recently filed *amicus* briefs in three federal circuit courts of appeal taking this position. Markups add to settlement costs and are inconsistent with our goal of assuring transparency in disclosures to consumers.

## **PREDATORY LENDING**

Finally, I would like to say a few words about predatory lending, an issue this Administration – and the Committee Members as well – are deeply concerned about.

Elderly and minority homeowners are particularly vulnerable to predatory lending practices. These practices include loan “flipping,” home improvement scams, unaffordable mortgage loans, repeated refinancings with no borrower benefit, and “packing” life insurance and other products into the loan amount.

We believe that our proposed reforms, and the greater transparency they ensure, will make it more difficult for unscrupulous lenders to abuse borrowers. But I want to be very clear that we do not consider RESPA reform to be a “silver bullet” solution to predatory lending. More must be done to address predatory lending while preserving a source of credit for those with less-than-perfect credit histories.

Consumer education and enhanced financial literacy are potent weapons in combating predatory lending. For this reason, the Department is currently providing \$20 million for consumer education and housing counseling, and has requested an additional \$15 million for this fiscal year, which we hope you will include in our appropriation this fall.

In addition, HUD has undertaken a number of other initiatives to fight predatory lending in FHA programs. These include:

- Strengthening oversight of FHA-approved mortgage lenders through the “Credit Watch” program, with the goal of identifying problem loans and lenders earlier on;
- Expanding protection of homeowners by proposing performance standards for appraisers of FHA single-family homes under the Department’s “Appraiser Watch Initiative”; and
- Developing a rule to stop “flipping” of FHA-insured properties.

HUD has played a key role in the Baltimore predatory lending task force. The combined efforts of federal, state, and local authorities, as well as profit and nonprofit organizations, has led to increased consumer education, restructured loans, and a large number of indictments. We believe that this approach can *and will* serve as a model for other areas targeted by predatory lenders.

## **CONCLUSION**

We believe that the Department has developed a well-crafted proposal. We look forward to reviewing the comments offered by the mortgage lending industry, consumers, government agencies at all levels, and others that will provide the basis for a final Rule. To be truly effective, the final Rule will require the full participation of each of these interests; therefore, we need to know whether the approaches we have proposed are the right ones – and if not, what alternatives may work better.

I am committed to creating a homebuying and mortgage finance process grounded in transparency and simplicity. By reforming the rules governing the purchase and financing of a home, we will create new opportunities for first-time homebuyers, keep the American dream of homeownership alive for more families, and inspire greater public confidence in the mortgage lending industry.

I would again like to thank the Committee for the opportunity to meet with you today. I appreciate your continued support of the Department's efforts, and I welcome your continued counsel as we work together on behalf of the American people.